A Program for Redistributing Sources of Revenue as between Cities, States, and National Government

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IN this reconstruction period following the World War there are certain to be important changes in our financial systems. It is earnestly to be hoped that whatever the changes may be they will represent movement towards rather than away from a theoretically ideal system. But in any event, the best we can expect is a compromise between the desirable and the attainable. The future historian of our present tax system and its changes will probably be able to reduce his outline to three main heads, as follows:

1. Right Principles (abstract justice).
2. The Expedient (administrative standpoint).
3. Compromise of the First and Second (program of taxation).

1. THE IDEAL SYSTEM

It is quite generally agreed that justice requires that the true basis of taxation should be the ability to pay. In carrying out this ideal scheme literally, no income should be exempt from taxation. This carries with it, of course, the further consideration that there should be no tax-exempt securities. To carry this important principle into practice would involve an amendment to the fundamental law of our land.

The foregoing considerations are based on abstract justice. The ideal system, from the administrative standpoint, is the most simple system. In short, to carry out to its logical conclusion the ideal system here, we are forced to come to the three forms of taxes, namely, land, income and inheritance.

Tax administrators tell us that a little, almost trivial, device may mean the difference between failure and success of a tax, so vital is the administrative contact problem. Hence, in any scheme of taxation we ought to aim at making our tax business conform to our orderly and well-established business methods. This means, in our ideal system, that a person should have presented to him one tax bill each year, covering all his taxes for all purposes, for all jurisdictions,—federal, state, and local. One check should settle this bill, if the person so desired, or suitable terms of payment (twice or three times a year) might be allowed, since this is not so important. The important thing is for the taxpayer to know definitely what the amount of his tax payment is to be, and to know in detail for what purposes it is to be used.

The contrast between the methods of paying the tax bill in some of our old eastern states and some of our newer states is so striking as to be worth illustrating. A tax officer from New York State was recently investigating fiscal matters in a middle western state. In his home state it was his custom to receive many separate tax bills during the year, for various jurisdictions and for different purposes. He found the middle western taxpayer receiving one itemized bill covering state, county, city, and school taxes, with the definite amount specified for each jurisdiction. One-half of this bill was due January 1 to March 1; that is, any time during two months. One check would settle half the bill or the whole bill, or the second half of the bill could be paid by

July 1. The time will ultimately come when the taxpayer will receive one tax bill for a definite amount covering his federal, state and city taxes. One tax bill and one check will pay it. This is an orderly business method.

2. THE EXPEDIENT

The first test any tax must meet is this one: Can it be administered; and will it be administered with a maximum of result and a minimum of effort? This concrete problem of administration takes precedence of the problem of a proper source of revenue now that the Federal Government is committed—and doubtless permanently committed—to taxing incomes, inheritances, and corporations. There no longer remain any sacred "fields" of taxation for the states. We may look forward with some confidence to the time when every state will also be taxing incomes and inheritances; corporations, of course, they already attempt to tax. Anticipating for the moment our discussion of the sources of revenue, let us consider two expedients now palpably and indisputably necessary in administering federal and state taxes, coöperation and decentralization.

Coöperation. The program of "segregation and separation" in federal and state tax administration is no longer workable. It is a violation of common sense that the two jurisdictions should go on working with disregard for the other's needs or methods. If the same property is to be taxed by the two jurisdictions, the nation and the state, then one valuation of that property is enough. Of course, the common sense of the administrators in charge of the federal income tax and the state income tax in such states as Wisconsin and New York, for instance, has already led to a considerable degree of voluntary coöperation. As one federal administrator remarked, referring to income and inheritance taxes:

> The fact or set of facts which in the last two or three months I think has been borne home to me most keenly at Washington is the increasing degree in which the tasks of the Federal Government—the federal official—and those of the state official are alike, common, identical.

Continuing this thought, the same official said, in substance, that it is expensive and extravagant for the Federal Government to be conducting a big administrative tax machine and for the state and local governments also to be doing it, one walking in the tracks of the other and not very closely scrutinizing the tracks of the other. "There should be some sort of coöperation."

Decentralization. The Treasury Department at Washington is too far removed from the taxpayer to administer successfully the income tax and the inheritance tax. The remedy for this defect is to decentralize this administrative work to such an extent that there would be, in effect, a joint administration of these two taxes with the state governments interested.

Coöperation and decentralization should be carried to the limit dictated by efficiency, and that limit is, apparently, joint administration of these common taxes, joint collection of the taxes, and a division of the proceeds. Such a program would cure two very outrageous evils in our present system; namely, the shifting of residence evil to avoid certain taxes, and the double taxation evil. It is putting it mildly to speak of "double taxation" under our present system, since certain property not only may be, but frequently is, legally taxed four times in one year.

3. THE COMPROMISE

The brief suggestions above on the administrative problems emphasize,

purposely, the importance of a tax system that will work out fairly well in practice. I want to insert here, in the way of an *obiter dictum*, my hearty disapproval of any "painless" system of taxation—of any plucking of the goose with the least squawk. Taxpayers will never take a proper interest in economy and efficiency in public expenditures until they feel the cost of such extravagance. Never will they take more than a languid interest in our customary governmental waste and extravagance till they feel some drain on their own pocketbooks.

Assuming that the federal tax burden for this year will be approximately $6,000,000,000 and for next year $4,000,000,000, we have a per capita federal tax of substantially $60 this year and $40 next year. This sum makes the federal tax burden heavier (to the average taxpayer) than his combined city and state tax. It is appropriate therefore to consider first the sources of federal revenue.

SOURCES OF FEDERAL REVENUE

(1) *Income tax.* The income tax should come first as a source of federal revenue. It should apply to all incomes of $1,000 and over. It should be a graduated tax. The present income tax rates should be readjusted in the higher brackets. For administrative reasons fifty per cent seems to be a high enough limit on the larger incomes, instead of the present rate of seventy per cent or over.

States with an income tax should have the power of adding on their tax to the federal income tax. In this manner, one reporting and one collection (a joint affair between state and federal government) would serve the purpose. There should be distributed back to the state its own share of the tax.

(2) *Corporation tax; excess profits tax.* The corporation tax is a going concern and should be kept as a federal tax, but as in the case of the income tax, certain readjustments are desirable. The excess profits tax, while it has a beguiling name, is a thoroughly discredited tax from the administrative standpoint and should be permanently discontinued. To compensate in part for the loss of revenue thereby occasioned, an increase should be made in the corporation tax. A flat rate of fifteen per cent seems to be the proper size for the corporation tax. By applying the income tax, at a low rate, to incomes as low as $1,000, an increase in the yield from this tax would further compensate for the loss of the excess profits tax. The corporation tax is used, in one form or another, by all the states. Federal and state taxes on corporations should be jointly administered. The state should keep the larger share of this tax.

(3) *Inheritance tax.* Only a few years ago the National Tax Association made a gallant fight to have the Federal Government keep its hands off the inheritance tax, but failed. Now most tax students are fully reconciled to having the Federal Government employ this form of taxation. Indeed, many are converted to the view that this tax is peculiarly well-suited to federal administration, owing to the ease with which residence can be shifted.

But like the two foregoing taxes, this is also a proper source of revenue for the state. Here again, as in the case of the income tax, it seems to be a good place for the state to add on its tax to the federal tax and have its own share distributed back to it. Our high tax authorities are agreed that most of the inheritance tax should be kept by the state.

(4) *Consumption tax; sales tax.* Our sales tax, as now in force, is a

monstrosity from every standpoint and should be abandoned *in toto*. Its rates, varying from three per cent to one hundred per cent, are a hint as to its administrative complexities. A consumption tax is always wrong in theory, but seems to be necessary as one of those "compromises" which constitute any working system of taxation. Consumption taxes should be looked on as supplementing the income tax. Those persons having incomes of under $1,000 (under the scheme above) would pay no federal tax at all if they were not reached by some form of indirect tax. A very short list of articles should come under the consumption tax. It is common to lay down the general principle here of "no tax on necessaries; heavy taxes on luxuries." No one can satisfactorily define luxuries, however. It is also considered proper to tax "harmful consumption" or "wasteful consumption."

It seems obvious that at least two commodities lend themselves to the consumption tax, namely, beverages and tobacco. It seems highly desirable, as well as expedient, to increase very materially the taxes on tobacco. The tremendous and rapid increase in the use of this weed, particularly by the young men in the form of cigarettes (by young men who would otherwise escape all federal taxes), and the concomitant and rapid rise in our annual fire loss (from fires attributable to cigarette and cigar stubs) mark out this commodity as a fit subject for much heavier taxes.

(5) *Customs*. The protective tariff is destined to play a smaller and smaller part in our budget. We are beginning to realize that if we will sell abroad we must buy. A "tariff for revenue" would have to be placed on some item of general consumption, such as coffee, and this sort of tariff, for political reasons, is not likely to be enacted. Customs duties should, from the standpoint of national welfare, form but a small fraction of our income, which is the case now. The present five or six per cent of the total federal revenue coming from this source might well be reduced to even lower terms.

These five taxes then—income, inheritance, corporation, consumption, and customs—should furnish the federal revenue. The first three should also furnish the states a large share of their revenues.

STATE AND CITY REVENUE

As just stated above, the state should secure jointly with the Federal Government revenue from three sources—incomes, inheritances, corporations. Complete separation of state and local sources of revenue is one of those tax shibboleths which is now in the discard. There should be some separation but not complete separation. Hence the state revenues collected from the three sources named above should in part be distributed back to the local subdivisions. In most cases (except to rural school districts) revenues should be distributed back on the basis, so far as practicable, of the amount collected or earned in that district.

Land Tax. The big source of revenue left untapped by the Federal Government is of course the land tax. In theory the "unearned increment" of land is a fit subject for taxation. Possibly this theory has some validity for city land, but for farm land it is difficult to see the justice of it or the feasibility of applying it. The pioneer who has seen the largest "increment" in the value of his land feels that the years of privations and hardships have earned him this increment. The exemption from taxation of all improvements on land (and all forms of personal property) is a desirable goal

towards which to travel. Ample revenues can be secured from the land taxes plus the three forms of taxes named first above.

It is not necessary or desirable to enter into a discussion of those various forms of fees and licenses which are now in use in the average American city. The aim of this article is to state in broad outline what seems sound in principle and workable in practice. The chief emphasis has been thrown on two things,—the federal tax system, and coöperation between the federal and state governments.

The State Tax Commission and the Property Tax

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THE property tax has been the most important single source of revenue for state and local purposes throughout the greater part of its career in the American colonies and states. This superiority has been maintained in recent times notwithstanding the tendency to diversification of revenue sources, the development or amplification of other taxes such as the income tax, the inheritance tax, and the multitude of corporation taxes. Thus, for the cities of more than 30,000 population, for which financial data are published by the United States Census Bureau, the property tax yielded 61.4 per cent of the total net revenue receipts in 1903, and 64.2 per cent in 1918.[1] For state purposes in all states the proportion of total net revenue receipts contributed through the property tax was 58.7 per cent in 1915 and 50.6 per cent in 1919; although two states, Pennsylvania and Delaware, reported no state receipts from this source in the latter year and the amounts obtained by several other states were trifling, due to the policy of separated sources of state and local revenues.[2] If we include the revenues of all other local subdivisions, such as the county, the village, the township and the school district, the proportion of total revenues derived from the property tax in every state becomes even greater. The property tax provided 76.4 per cent of all county revenue receipts in 1913, and 61.1 per cent of all revenue receipts for all incorporated places of 2,500 population and over.[3] It is quite evident, therefore, that the property tax has been and will continue to be the great foundation of the local revenue system of the American states and that it is, generally speaking, the most important single resource for the state governments, notwithstanding the extent to which segregation of state revenue sources has been carried.

In view of the present and probable future importance of the property tax, the problem of its efficient and equitable administration becomes one of the most important and significant phases of state and local tax administration. There is quite as much at stake in improving the operation of the property tax as in any other line of administrative reform in taxation that may be undertaken. Obvious as this truth is, there are some states in which it has

[1] United States Bureau of the Census, *Financial Statistics for Cities*, 1918, *p.* 54.

[2] *Ibid.*, Financial Statistics of States, 1919, *p.* 33.

[3] *Ibid.*, Report on Wealth, Debt and Taxation, 1913, *pp.* 298, 658.